I. INTRODUCTION

The continued viability of a bank depends on its ability to earn an appropriate return on its assets and capital. Good earnings performance enables a bank to fund its expansion, remain competitive in the marketable, and replenish and/or increase its capital funds.

From the standpoint of the bank supervisor, the essential purpose of bank earnings, both current and accumulated, is to provide for absorption of losses. The earnings power of a bank is the initial safeguard against the risks of engaging in the business of banking. Earnings, therefore, represent a bank's first line of defense against capital depletion resulting from shrinkage in asset value.

II. ANALYSIS OF BANK EARNINGS

The basic analytical tools available to the examiner are the Uniform Bank Performance Report (UBPR), the Uniform Bank Performance System (UBPS) reports, and the financial statements of the bank. Internally prepared statements and supplementary schedules, if available, augment in-depth review. The information from those schedules may give the examiner considerable insight into the interpretation of the bank's basic financial statements. Internally prepared information is not in itself sufficient to adequately analyze the financial condition of the bank. To properly understand and interpret financial and statistical data, the examiner should be familiar with current national, regional and local economic and industry conditions, and any secular, cyclical or seasonal factors. Current knowledge of such conditions and factors by reviewing appropriate economic and industry information such as that available in newspapers and industrial journals, is important to the examiner in adequately reviewing and analyzing a bank.

In addition, the existence of a bank holding company affiliation cannot be ignored when analyzing bank earnings, due to the impact the parent company may exercise over the subsidiary bank in several important areas. These include the level of management fees, extent of dividends, amount of income tax payments upstreamed to the holding company, and type of earning assets employed by the bank.

In the analysis of bank earnings, the primary focus is placed on income before securities transactions rather than on net income. The difficulty with net income in bank analysis is that it includes realized gains (or losses) on investment securities. These transactions usually occur at the discretion of management in order, for example, to maintain a proper maturity balance, maximize portfolio yield, or effect some degree of control over income tax liability. Therefore, such gains and losses may not be truly reflective of the bank's operating performance during a give accounting period.

By contrast, other forms of income and expenses are (or ought to be) attributed to the accounting periods in which they occur, and thus are deemed to be "operating" as opposed to "nonoperating" transactions. Income before securities transactions, therefore summarizes the results of operations. A synonym for income before securities transactions is net operating income (NO) and is a more reliable guide to a bank's performance during the period than is net income.

An analytical review of a bank's financial statements requires professional judgement, imagination and discrimination. Examiners should avoid details that may superficially relate to their objectives. It is important to maintain a sense of proportion when analyzing the statements and avoid spending excessive time on relatively immaterial amounts. An evaluation of the meaning of the ratios and amounts compared is important and should be the focus of the effort. When comparing data on the bank under examination to peer group data, the examiner should consider whether the bank is typical for its peer group.

Alternative accounting treatments for similar transactions also should be considered because they may produce significantly different results. Accordingly, during an analytical review, the examiner should determine any material inconsistency in the application of accounting principles.

In evaluating and rating earnings it is not enough to review past and present performance. Future performance is of equal or greater importance. A review for reasonableness of the bank's profit plan and budget, with particular attention to the underlying assumptions, is appropriate for this purpose. The bank's forecast and assumptions should be consistent with what the examiner knows about the bank, such as the volume of classified assets, nonaccrual and renegotiated debt levels, the adequacy of the reserve for loan losses and other examination findings that have an earnings implication. In addition, an obvious reasonableness check is to compare the bank's forecast to actual past performance as displayed in the bank's own reports and in the UBPR. Any material discrepancies should be discussed with management; and, if the explanation is unreasonable, the examiner may need to adjust the bank's forecast to determine the effect of more reasonable assumptions. If there is no bank plan, examiners may need to develop their own forecast to aid in their judgements. In any case, it will normally be necessary to discuss future prospects with management. Care should be taken in these discussions not to present the examiner's forecast as absolute, or to recommend specific strategies or transactions to management based on an examiner's forecast. Planning is properly the function of management. Examiner efforts are only an attempt to discover any undue risk and highlight any factors that may significantly impact future performance in either a positive or negative manner.

Level and Trend of Earnings

The first step in the analysis of any bank is to measure the level of earnings; the second step is to measure the trend of earnings.

Level - The best and probably most widely used single indicator of the level of bank earnings is the ratio, return on average assets (ROA), or net operating income as a percent of average assets. The value of the ratio is that it permits an instantaneous inspection of the level of earnings. Norms for ROA are different, depending on the sized location and type of bank. For example, a "community" bank with a few branches may regularly achieve an ROA ratio which exceeds those realized by large wholesale banks.

Another equally important measure of earnings level is the ratio of adjusted return on assets, where net charge-offs are substituted for the loan loss provision in the calculation of earnings. It is important to modify the ROA in this way because bank managements exercise discretion in their funding of the loan loss reserve, with the result that net charge-offs may not match the loss provision. For example, if the loss provision is only 50% of net charge-offs, current net operating income is overstated relative to the other banks which take a loss provision equal to the amount of net charge-offs. Conversely, earnings may be understated if the loss provision is 200% of net charge-offs. In certain situations, such as during times of increasing loan volume, it would be normal for the loan loss provision to exceed net charge-offs. Under these conditions, it is also typical for adjusted return on assets to exceed ROA based on reported net operating income. When adjusted return on assets falls below ROA an examiner may suspect earnings overstatement, and vice versa.

Trend - The trend of earnings is measured in two ways: net operating income growth and return on assets history. Earnings growth should be inspected for year-to-year changes and for a five-year annual compound growth rate; and average annual growth rate may be substituted for the latter. The return on assets history is simply the tabulation of five consecutive return on asset ratios. By utilizing both measures of earnings trends, a comprehensive determination can be made as to the technical validity of the data itself. To illustrate, the Report of Income form is changed form time to time, bank accounting practices change, mergers occur, yet no restatements of prior years are available in any Report of Income. Thus, the possibility always exists that an apparent compound (or average) earnings growth of, say plus 10% is misleading and might actually be minus 10% if proper restatement were made. These restatements, however, are time consuming and far from necessary except in problem cases where the extra analytic effort may be fully justified.

An easy analytic substitute for testing whether restatement is necessary does exist, and involves inspecting the five-year trend of return on assets. If the trend is unchanged, say 0.90 percent in each of the five previous years, then a 10% earnings growth rate implies a 10% asset growth rate and may be confirmed by measuring asset growth itself. In this case, a high "reassurance" factor exists that restatements, if any, would be minor. But if a 10% earning growth rate exists and the return on assets trend is negative, say from 0.90% in year 1 to 0.50% in year 5, then one or both of two things is true: assets have been acquired in mergers and are low in profitability, thus pulling down the aggregate return on assets even while additional dollars of net operating income have been earned; and/or, with or without mergers, the bank has engaged in rapid asset expansion as a sacrifice to profitability per asset even while additional dollars of net operating income have been earned from these much less profitable assets. In any event, measuring trends in both net operating income growth and return on assets is essential for the proper evaluation of earnings.

Analysis Trails

Through use of analysis trails, the causes of bank performance, especially of bank performance, can be ascertained. In order to make this analysis, examiners must track down the sources of earnings through "analysis trails" that can give signals or indicators. The earnings analysis trail passes through five areas which constitute the five sources of bank earnings: net interest income (analyzed on a taxable equivalent basis), noninterest income, overhead expense, provision for loan losses, and income taxes.

An additional sixth area, dividends, focuses on the retention of earnings, an important step in capital enhancement.

Net Interest Income - Earnings from interest is the difference between total interest income and total interest expense. In a sense, interest expense is considered to be the equivalent of the "cost of goods sold" which nonfinancial businesses incur.

Earnings from interest is clearly the major source of bank operating income, comprising most of the total income available to cover expenses other than interest expense. The terms used are as follows: net interest income is what has been called net earnings from interest while net interest margin is the net yield which earnings from interest represent on gross earning assets (that is, all financial assets or all assets earning an interest-type return, including leases and repurchase agreements). Therefore, net interest income is total interest income less total interest expense; net interest margin is provided by dividing net interest income by average gross earning assets.

Total interest income and net interest income should be computed on a taxable equivalent (TE) basis for analysis purposes. This is necessary because the before-tax yield on a tax-exempt municipal security does not accurately reflect its economic value. For example, the value of a tax-exempt obligation to a bank in a 50% income tax bracket is equal to that of a taxable security with twice as much of a before-tax yield. In order to place yields for taxable and tax- exempt securities on a comparable basis for analytical purposes, both total interest income and net interest income are increased by an amount equal to the income tax savings generated from investments in tax-exempt securities. This adjustment is required to compare the performance of the bank under examination with that of the peer group.

The analysis of interest income may be complicated by the existence of a diversity of accounting treatment for nonrefundable fees and costs associated with lending activities. FASB Statement No. 91, which must be applied to all lending and leasing transactions in fiscal years beginning after December 15, 1987, establishes the accounting for nonrefundable fees and costs associated with lending, committing to lend, and purchasing a loan or group of loans. In general, it specifies that:

1. Loan origination fees should be recognized over the life of the related loan as an adjustment of yield;

2. Certain direct loan origination costs should be recognized over the life of the related loan as a reduction of the loan's yield;

3. Most loan commitment fees should be deferred, except for specified exceptions; and

4. Loan fees, certain direct loan origination costs, and purchase premiums and discounts on loans shall be recognized as an adjustment of yield generally by the interest method based on the contractual term of the loan.

A more detailed discussion of FASB 91 and loan fees is included in the Instructions for the Preparation of Reports of Condition and Income. Examiners should note that the rules apply only to loans originated or acquired by a bank after it adopts FASB 91 unless the bank chooses retroactive application.

Prior to adopting FASB 91, banks generally could immediately recognize in income those fees that represented a reimbursement to the bank for actual origination costs incurred by the bank.

Noninterest Income - The second major type of bank income is largely of a fee nature; service charges on deposits, trust department income, mortgage servicing fees, commitment fees, and certain types of loan fees. Also included are the results of trading operations and a variety of miscellaneous transactions, usually insignificant.

Since a bank's financial statement presentation does not permit analysts to study the expenses specifically associated with these types of income, there is no direct way of judging the profitability of fee-related activities of the bank, nor the impact their profit (or loss) has on overall profitability. However, an indirect method of measuring this revenue is to inspect the sheer size of the noninterest income as a percentage of adjusted operating income. If the fraction is small and steady, the potential for significant impact on profit or loss is undoubtedly small. If the fraction is large, the potential impact is larger and may necessitate further investigation. This is even more the case when "other income" shows sharp year-to-year fluctuation.

Overhead Expense - Another method for judging the profitability of noninterest income is to inspect the overhead ratio of a bank. Overhead is the sum of all bank operating expenses except interest expense and loan loss provision. The notable exception is the cost and losses associated with foreclosed property (other real estate owned, or ORE). If the bank has a significant amount of ORE, the expenses associated with ORE will flow through "other expenses" and are thus included in overhead. Therefore, any sharp rise in the overhead ratio may be caused by the result of write-offs of former real estate loans.

A useful ratio to measure the appropriateness of overhead is overhead as a percentage of adjusted operating income. But the range of the ratio is dependent upon the width of the net interest margin and the profitability of other income. Another ratio that may prove helpful is the ratio of overhead expense to average assets. If the extent of overhead expense appears large, further analysis should be performed to determine the specific cause(s). Excessive salaries and bonuses, sizable management fees paid to the bank holding company, and high net occupancy expenses caused by the purchase or construction of a new bank building are examples of the type of costs which may lead to an inordinately high level of overhead expenses.

The extent of overhead relating to salaries and net occupancy expense may also be unduly large if bank personnel, space, and equipment is partially utilized for nonbanking activities. An example is an insurance agency which occupies a portion of bank premises and is owned by a party other than the bank, which party receives all profits from the operation of the agency. In order to ensure that the bank is adequately compensated, FDIC policy requires the owner of such an insurance agency to reimburse the bank for the dollar value of bank space, employee time, and equipment used by the agency. Such reimbursement reduces the amount of bank overhead expenses to an equitable level, and also provides for a more appropriate comparison, from the financial analysis viewpoint, of the level and trend of overhead expenses.

The existence of unwarranted and unjust compensation of bank insiders is of particular concern, especially when those expenses are likely to result in harm to the bank or the FDIC fund. While just and equitable employee and directorate compensation is essential for the acquisition and retention of competent management, there are instances where bank insiders have profited from unwarranted direct compensation or other forms of emolument. Unwarranted and unjust compensation and related expenses to bank insiders should be dealt with through whatever means are necessary to cease those abuses. This is particularly critical in lower rated banks and banks receiving FDIC financial assistance. In such banks the directorate should be reminded of their fiduciary responsibility for the preservation and conservation of bank funds.

Allowance for Loan and Lease Losses - The adequacy of a bank's allowance for loan and lease losses continues to be one of the principal factors examiners must consider when evaluating the quality of a bank's earnings performance. Examiners should therefore ensure that bank management reviews the adequacy of its "allowance" on at least a quarterly basis. Furthermore, management must maintain reasonable records in support of their evaluations and entries. Refer to the Loans Section for further discussion.

In many instances the transfer taken by the bank as a deductible bad debt expense on its Federal income tax return will vary from the operating expense provision utilized for Call Report and book income statement purposes. This variance results from the significant differences which can exist between the Report of Income operating expense provision (which is used to offset actual and potential loan losses) and the method allowed to calculate maximum bad debt deductions for Federal income tax purposes. While the "provision for loan and lease losses" operating expense on the Report of Income must be the amount necessary to restore the "allowance for loan and lease losses" valuation account to an adequate level, calculations of bad debt tax deductions have generally been computed by using either the percentage method or the experience method.

Therefore, if a bank's past loan loss experience has been nominal, and if current estimates reveal no anticipated increase in charge-offs, the amount reflected as a "provision for loan and lease losses" operating expense in the Report in Income may very well be less than the bad debt deduction calculated for Federal Income tax return purposes. The probability that the bad debt tax deduction would exceed the Report of Income "provision" was especially prevalent prior to 1982, the time period during which the percentage method allowed much larger bad debt deductions for Federal income tax return purposes than the amount that is allowed under the present law.

On the other hand, during a year when a large operating expense "provision" is reflected on the Report of Income due to deterioration in credit quality of the loan portfolio, the Call Report "provision for loan and lease losses" may possibly exceed the maximum transfer allowed as a bad debt deduction on the Federal income tax return. Beginning with 1983, a Report of Income "provision" that exceeds the bad debt tax deduction has become a more common occurrence because many banks must add "provisions" to their valuation account which are greater than the amount presently allowed as a bad debt deduction for Federal income tax return purposes under the percentage method.

Whenever the "provision for loan and lease losses" operating expense reflected in the Report of Income differs from the transfer taken as a tax deduction for Federal income tax purposes, an income tax effect must be recognized for this timing difference. These timing differences are of significance since all banks, regardless of size, are required to report "applicable income taxes" on an accrual basis for Call Report purposes. Therefore, the income tax effect associated with the timing differences should be considered when calculating the "applicable income taxes" expense reflected in the Report of Income.

Although timing differences associated with the bad debt reserve may reverse, an increase in the valuation account cannot be accomplished by directly transferring the amount of deferred income tax liability to the valuation account. In this respect, such a direct transfer method cannot be used to turn around the cumulative timing differences between bad debt tax transfer and Call Report operating expense provisions.

Income Taxes - The fifth major earnings component in any bank is income taxes. It is important in the analysis of earnings to judge whether income taxes, that is, the provision for taxes in the income statement, seem appropriate and whether a shift in the effective rate has occurred.

In determining the appropriateness of income taxes, several tax ratios are provided within the UBPR. These ratios generally compare the amount of applicable taxes to net operating income. In order to ensure that only taxable income is compared to ensure that only taxable income is compared to applicable income taxes, certain adjustments are necessary for income received on municipal securities and other investments which are tax-exempt in nature. If the tax ratios provided on the UBPR differ significantly from the rate of taxes that should have been paid, based upon bank's tax bracket, further analysis is necessary to determine the reasons for such a discrepancy. For example, a bank with high ratio may have invested too heavily in tax-exempt assets, with the result that the potential tax savings were unable to be fully realized. In addition, certain tax incentives, such as investment tax credits received in connection with the acquisition of bank equipment, may have the effect of lowering the tax rate. The ability or inability to carry back or carry forward operating losses for tax purposes will also impact the bank's effective tax rate. An unusually low tax ratio may be indicative of a bank which prepares its books on an accrual basis of accounting and files taxes on a cash basis, but which has not made an adequate provision for income taxes of a deferred nature. Tax ratios may also appear abnormal due to management's failure to adequately accrue for income tax expense on a current basis. Appropriate tax accruals should be made on a regular basis, and at least with enough frequency to allow for the preparation of accurate Reports of Income, from which many of the UBPR earnings figures are obtained.

A higher than normal ratio of applicable income taxes to NOI may also result from upstreaming income tax payments to a bank holding company. The FDIC has issued a policy statement (refer to the Prentice-Hall volumes) which covers such income tax remittances by banks to holding company affiliates. In general, the statement requires that cash transfers paid by the bank to the holding company shall not exceed the amount of tax the bank would have paid had a tax return been filed on a separate return basis. In addition any payments made to the holding company shall not be required to be remitted until such time as those payments would have been due to the taxing authority. Thus, deferred income taxes on bank's books should not be upstreamed to the holding company until such time as those taxes would be otherwise payable to the Internal Revenue Service. Establishment of a formal tax allocation policy between the bank and the holding company is considered to be consistent with the responsibilities of the bank's board of directors.

The policy statement was not intended to limit any tax elections under the Internal Revenue Code, and the term "separate return basis" recognizes that certain adjustments due to particular tax elections may, in certain periods, result in larger payments by the affiliated bank to the parent than would have been made by an unaffiliated bank to the taxing authority. This is due to the fact that a bank holding company and its related subsidiaries generally are limited, as a group, to one surtax exemption. The surtax exemption refers to the lower rates of income tax payable on taxable income of less than $100,000. If the tax ratio remains high, even after taking this surtax exemption limitation into account, the possibility of excessive upstreaming of income tax payments to the holding company exists and will therefore require further analysis of bank records.

Dividends - The rate of earnings retention is directly related to increasing capital. High retention obviously increases capital more rapidly but may or may not be appropriate or necessary for the bank. The retention rate must be analyzed relative to the potential growth rate of the bank. A bank in a developing trade area may forecast substantial growth which cannot be supported by existing capital even if no cash dividends are paid. Since most bank equities are viewed by the investor as income rather than growth stocks, a low dividend history may hamper the bank's ability to market a new stock offering. The bank's flexibility to reduce its dividend payments should also be considered when analyzing the impact of dividends upon earnings. For example, a bank that must upstream dividend payments to a highly leveraged holding company which needs those dividends to meet its debt service requirements may not have the flexibility, given the current structure of its liabilities, to significantly lower its dividend level. Of course, it is desirable from a supervisory standpoint to prevent this type of situation from developing in the first place.

Earnings retention becomes an even more important area of bank analysis when outside capital is scarce. Furthermore, the analysis of dividend policy, from the perspective of capital enhancement, allows the analyst to make a natural transition from income to condition analysis, in which the first step will be to measure capital adequacy. If growth is low, profits high, and capital strong in relation to assets, a relatively high dividend payout ratio may be acceptable. On the other hand, if growth is rapid, profits are low, and capital is weak, a high dividend payout stands in the way of retaining needed capital. Under such circumstances, a lower payout ratio would clearly be appropriate.

In undercapitalized banks, steps should be taken to strongly discourage the continuation of cash dividends. If necessary, additional steps should be taken to administratively prohibit such dividends where the bank is undercapitalized and has a high risk profile, or is substantially undercapitalized, no matter what the degree of perceived risk. There may be isolated instances where the continuation of cash dividends is warranted even under fairly severe circumstances. In such cases, the continuation of these payments without supervisory action should be fully supported.

III. QUALITY OF BANK EARNINGS

The preceding discussions have centered on the level and trend of bank earnings and on key areas affecting profitability. As important as these factors are, an analysis of bank earnings would not be complete without a determination as to the quality of the institution's earnings, that is, the ability of a bank to continue to realize strong earnings performance.

It is quite possible for a bank to register impressive profitability ratios and high dollar volumes of income by assuming an unacceptable degree of risk. An inordinately high return on assets is often an indicator the bank has assumed too high a degree of risk. Bank management may have taken on loans or other investments which provide the highest return possible, but are not of a quality to assure either continued debt servicing or principal repayment. By seeking higher rates on earning assets to underwrite an increased credit risk associated with that asset, short-term earnings will be boosted. Eventually, however, earnings may suffer if losses in these higher-risk assets are recognized. In addition, certain of the bank's adversely classified and nonperforming assets, especially those upon which future interest payments are not anticipated, may need to be reflected on a nonaccrual basis for income statement purposes. If such assets are not placed on a nonaccrual status, earnings will be overstated. Similarly, assets which have been restructured in accordance with guidelines dealing with troubled debt restructurings may have an adverse impact on earnings if material in amount. Thus, the analysis of the institution's asset quality, a major function performed in the safety and soundness examination, has a close relationship to the analysis of earnings quality. The adequacy of transfers to valuation reserves in light of this asset quality must be reviewed for its impact on earnings quality.

Additionally, short-term earnings performance can be enhanced by contributions made to net income by extraordinary items and tax considerations. For example, a bank may dispose of high-yielding assets to record gains in current periods, but be able to reinvest the funds only at a lower rate of return. Levels and trends in earnings performance would be quite positive, although future income potential is sacrificed. Again, this is another reason why the examiner should primarily base the evaluation of earnings on net operating income rather than net income. Conversely, a bank might dispose of assets at a loss to take advantage of tax loss carryback provisions and enhance future earnings potential. Current earnings levels and trends would be poor in such a case, but funds recaptured through this strategy may greatly improve future earnings capacity. The point is that no analysis of earnings is complete without a consideration of earnings quality and a complete investigation and understanding of the strategies employed by bank management.

IV. PROFIT PLANS AND BUDGETS

In addition to an analysis of the bank's past earnings, the examiner needs to determine whether there is a profit plan or budget for the current and/or next operating year. A profit plan is an overall forecast of the income statement for the period based on management's decisions, intentions and their estimation of economic conditions. It addresses such things as the anticipated level and volatility of interest rates, local economic conditions, funding strategies, asset mix, pricing, growth objectives, interest rate and maturity mismatches, etc. The accuracy of any such plan is susceptible to the attainability of the aforementioned assumptions. Examiners should discuss the assumptions with management, and address in the comments section, those areas which do not appear realistic in the given market environment. The ongoing effect of any variances from strategic or business plans must also be factored into the analysis of the projections, with appropriate comment, where such variances will have a material adverse impact on the attainment of projected results.

Within the profit plan is a budget. The budget is essentially an expense control technique where management decides how much is intended to be spent during the period on individual overhead expense items. The budget should be consistent with the overall business or profit plan.

Although it is recognized the degree of sophistication or comprehensiveness of an operating plan may vary considerably depending on the size of the institution or other factors, all banks, regardless of size, should be encouraged to prepare a profit plan and budget. It should be initially prepared by management and approved by the board of directors of the bank, as well as periodically reviewed and updated for changing conditions. Actual results should be compared to the projections, and any significant variances should receive appropriate review by management and the board of directors. The initiation and periodic review of a profit plan and budget for earnings not only provide bank management with an effective administrative control, but also allows the examiner to obtain a more thorough analysis and understanding of any unfavorable income and expense trends.

V. RATING BANK EARNINGS

Consistent with the Uniform Financial Institutions Rating System, earnings performance will be rated "1" through "5" upon consideration of: the ability of earnings to cover losses and augment capital; earnings levels and trends; comparisons with peers; and the quality and composition of income. The interrelationships between the rate of growth in earnings, dividend payout and the adequacy of a bank's capital must also by analyzed. A dividend payout greater than warranted given the bank's capital level and trend, would suggest a lower rating than might be assigned based on an appraisal of earnings performance alone. The quality of earnings is an important factor in rating earnings performance. The adequacy of transfers to valuation reserves and the extent to which extraordinary items and tax effects contribute to earnings performance must be considered.

Earnings rated "1" are sufficient to make full provision for the absorption of losses and the accretion of capital when due consideration is given to asset quality and bank growth. Generally, banks rated "1" will have earnings well above peer group averages. Banks rated "2" may have relatively static or even downward trending earnings provided its level of earnings is adequate in view of the factors discussed above. A bank rated "2" will normally have an earnings level in line with or slightly above peer group norms. A "3" rating should be accorded earnings that are not sufficient to make full provision for the absorption of losses and the accretion of capital in relation to bank growth. The earnings performance of such banks may further be clouded by factors such as static or inconsistent earnings trends, chronically insufficient earnings, an unjustifiably high dividend payout rate or less than satisfactory asset quality. Earnings of such banks are generally below peer group averages. Earnings rate "4", while generally positive, may be characterized by erratic fluctuations in net income, the development of a downward trend, intermittent losses, or a substantial drop from the previous year. Earnings of such banks are ordinarily substantially below peer group averages. Banks accorded a "5" rating should be experiencing losses or reflecting a level of earnings that may represent a distinct threat to the bank's solvency through the erosion of capital.